

Market Commentary for January 2009

The Hits Keep On Coming

To say the year has gotten off to a rocky start would be an understatement. Wall Street remains in turmoil, jobs continue to be shed, the housing market is not recovering, and consumers are earning and spending less than in prior months. As of this writing, the U.S. House of Representatives has passed an \$825 billion economic stimulus bill labeled the American Recovery and Reinvestment Act. The Senate is currently altering and amending the legislation in an attempt to get more bipartisan support. The end product will likely exceed \$900 billion and possibly even \$1 trillion. As it stands, the stimulus package is a mix of public works projects, infrastructure spending, tax cuts, homeowner-targeted relief, and various other initiatives that some critics have labeled as pork barrel spending. Senate leaders have vowed to strip away the parts of the legislation that do not have a demonstrable effect on stimulating the economy.

In the fourth quarter of 2008, U.S. Gross Domestic Product (GDP) shrank by a 3.8 percent annualized rate, the biggest drop since 1982, but well below the 5.0 percent decline previously expected for last quarter. Even so, GDP is estimated to contract a further 2.7 percent in the first quarter of 2009. According to Moody's, the U.S. economy is "in the midst of the worst recession since the Great Depression."

The jobs situation is dismal. The unemployment rate rose sharply from 7.2 percent in December to 7.6 percent in January. In January alone 598,000 jobs were shed, the most since 1974, and payroll employment has fallen by 3.6 million since December of 2007, half of which occurred in the last three months, making for the worst three month loss since 1945.

Consumer attitudes are in line with those typically found in a deep recession. The University of Michigan Consumer Sentiment Survey rose a slight 1.1 points to 61.2 in January, but is still hovering in near-historic low territory. The index tracks both consumers' perceptions of present conditions and expectations for the future. In a reversal of last month, the present conditions component fell by three points, while expectations rose by 3.8 points. The rise in expectations may be due to hopes surrounding the forthcoming government stimulus package. The other major consumer sentiment gauge, the Conference Board index of consumer confidence decreased to 37.7 from 38.6 in December. This is the lowest recording of the index

in its nearly 25 year history. Personal income decreased by 0.2 percent in December, the largest wage decline since April, while consumer spending fell 1.0 percent in the same period. Prices softened throughout last year, with the top-line Consumer Price Index (CPI) falling 0.1 percent in 2008 and the core CPI increasing a miniscule 0.1 percent for the year.

There is still no substantive hope on the housing front yet, although existing home sales showed a surprising increase of 6.5 percent in December over the previous month. Still, sales fell 13 percent in all of 2008 and the median home price decreased by 9 percent. New home sales have fared even worse, plummeting 14 percent in December month-over-month, which means the pace at which new homes are selling is at a 45 year low.

Although official figures are not yet in, U.S. corporate earnings likely fell again in the fourth quarter of 2008, which would mark the sixth straight quarterly decline and the longest slump in 20 years. Durable goods order sank 2.6 percent in December and decreased 5.6 percent for all of 2008. There has been a particular weakness in capital goods orders, indicating that businesses have stopped making investments in equipment. The Institute for Supply Management (ISM) manufacturing index, which measures the overall state of U.S. manufacturing, actually jumped 2.7 points to 35.6 in January, ending a five month streak of declines. Unfortunately, the index is still far below 50 and therefore in severe recessionary territory. The increase may have been a result of manufacturers liquidating their excess inventories.

The Federal Open Market Committee (FOMC) met on January 28 and has decided to keep the fed funds target rate between 0 and 0.25 percent for the foreseeable future, which was lowered from 1 percent at its December 16 meeting. In a statement the FOMC announced, "Information received since the Committee met in December suggests that the economy has weakened further. Industrial production, housing starts, and employment have continued to decline steeply, as consumers and businesses have cut back spending. Furthermore, global demand appears to be slowing significantly... The Committee anticipates that a gradual recovery in economic activity will begin later this year, but the downside risks to that outlook are significant."

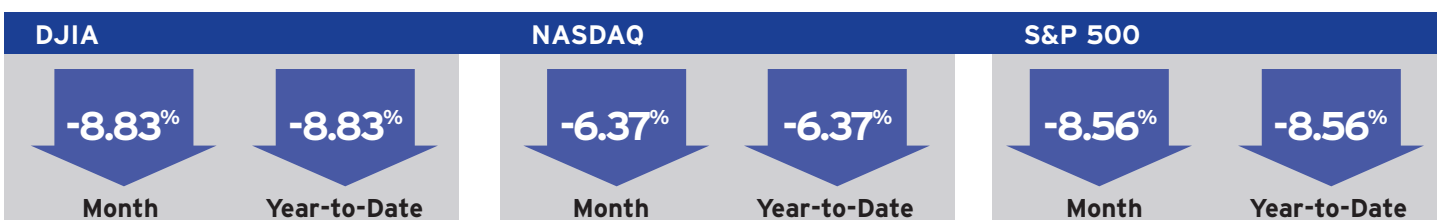
Sector Review

U.S. Treasuries: The Federal Reserve maintained its current target range for the federal funds rate at 0.00 percent to 0.25 percent and indicated that it was going to continue using all of the tools it has available to help address the economic and financial system weakness that has pervaded since mid-2008. Longer dated yields on Treasuries began to sell off as certain risk sectors attracted investor interest and Treasuries met less demand. The 10-year note yield increased to a 2.84 percent yield from a 2.12 percent yield the prior month. The two-year note yield increased to a 0.94 percent yield from a 0.76 percent yield while the three-month Treasury bill saw yields increase from at or near 0.01 percent to 0.22 percent. (Rates and prices maintain an inverse relationship. Prices decrease as yields increase).

Commercial Paper: Federal Reserve holdings of commercial paper (CP) in the Commercial Paper Funding Facility (CPFF) dipped to \$248 billion as the month ended compared to mid-month when it held on to as much as \$350 billion. This was a signal that this vehicle had provided issuers some time to reorganize their funding sources and also helped to provide some continued stability to the overall market. One-month, top-tier, higher quality asset-back commercial paper (ABCP) names traded between 0.40 percent and 1.25 percent and three-month paper traded between 0.65 percent and 1.75 percent.

U.S. Government Agencies: A topic of interest to many short-term money managers is the handling of the Temporary Liquidity Guarantee Program (TLGP) bonds issued into the market. Because of the FDIC guarantee attached to these bonds, asset managers and rating agencies have been trying to identify if these assets will be approved for agency and government guaranteed portfolios. One ratings agency opined on December 8 that these securities would be considered as U.S. government paper for issuer concentration purposes, however the SEC has yet to officially determine that they agree with this and are reviewing the matter. Agency yields at month-end on three-month paper yielded near 0.20 percent, six-month paper yielded 0.50 percent, and 12-month paper yielded 0.90 percent.

Strategy: The Federal Reserve continued to maintain its federal funds target range between 0.00 and 0.25 percent. The continued deterioration of labor market conditions and the decline in consumer spending, business investment, and industrial production continue to be a source of concern for the Federal Reserve and continue to create challenges for all asset managers. We remain very defensive regarding our strategy by attempting to maintain ample cash while trying to be very selective identifying and implementing trade opportunities to add yield available in the longer part of the money market curve.



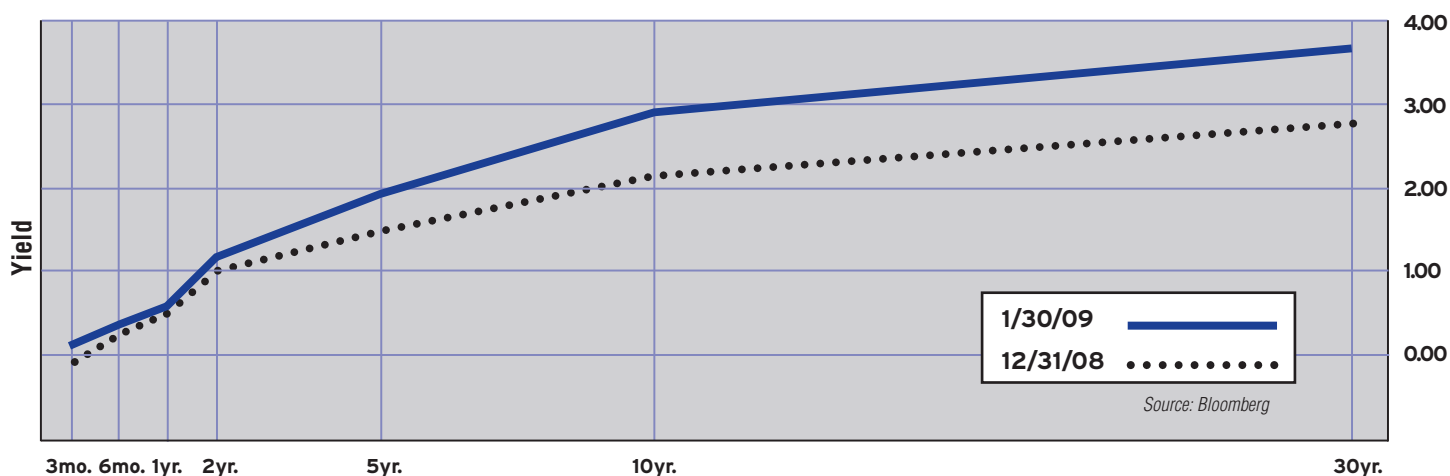
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Market Summary for January 2009

Monthly Market Summary - Week-ending Rates and Yields

	01/02	01/09	01/16	01/23	01/30	1st QTR AVG
Overnight Rates						
Effective Fed Funds	0.08	0.09	0.19	0.18	0.23	0.15
Repurchase Agreements	0.05	0.05	0.25	0.20	0.20	0.15
Discount Rates						
1 Month Treasury Bill	0.01	0.04	0.03	0.03	0.14	0.05
1 Month Agency Disc.	0.04	0.07	0.14	0.18	0.17	0.12
1 Month Com'l Paper	0.41	0.17	0.24	0.35	0.42	0.32
3 Month Treasury Bill	0.04	0.06	0.10	0.10	0.21	0.10
3 Month Agency Disc.	0.14	0.17	0.28	0.35	0.34	0.26
3 Month Com'l Paper	0.84	0.54	0.53	0.65	0.92	0.70
6 Month Treasury Bill	0.17	0.20	0.22	0.24	0.31	0.23
6 Month Agency Disc.	0.37	0.36	0.38	0.48	0.51	0.42
6 Month Com'l Paper	1.16	0.79	0.85	1.10	1.25	1.03
Yields						
1 Year Treasury	0.40	0.43	0.43	0.46	0.51	0.45
1 Year Agency	0.67	0.61	0.56	0.66	0.70	0.64
2 Year Treasury	0.82	0.75	0.73	0.81	0.95	0.81
2 Year Agency	1.44	1.50	1.51	1.65	1.63	1.55
5 Year Treasury	1.65	1.51	1.47	1.63	1.88	1.63
5 Year Agency	2.56	2.45	2.44	2.60	2.74	2.56

Historical Yield Curve



Key Economic Indicators

	For the Period	Date of Release	Expected	Actual	Prior
Unemployment Rate	January	02/06	7.5%	7.6%	7.2%
Consumer Price Index	December	01/16	-0.2%	0.1%	1.1%
- Less Food and Energy	December	01/16	1.8%	1.8%	2.0%
Consumer Conf. (CB)	January	01/27	39.0	37.7	38.6
FOMC Rate Decision		01/28	0%-0.25%	0%-0.25%	0%-0.25%
Gross Domestic Product	4QA	01/30	-5.5%	-3.8%	-0.5%

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